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MANUFACTURERS HANOVER

Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

Financial Market Blues

With the first anniversary of the great stock market collapse of October 1987 quickly approaching, the common characteristic of virtually all the financial markets, ranging from the long-term bond market to the stock market to the foreign exchange market, seems to be lethargy. After moving decidedly lower in recent weeks, long-term Treasury bond yields, for example, have become stuck in the neighborhood of nine percent–exactly where they stood at the end of last year–equity prices have been locked within a narrow trading range all year long and the ascent of the dollar in the foreign exchange markets has been capped for the moment by the certainty of central bank intervention at dollar levels any higher than where they are now.

Some of today's "wait-and-see" inactivity stems from the uncertainty surrounding the upcoming Presidential elections. However, the malaise probably runs much deeper than this, and stems largely from an almost total lack of conviction among market participants as to where the economy, inflation rates and interest rates will be, say, six months from now–and there is little on the horizon which will provide clear-cut evidence of what's ahead.

To be sure, it might be argued that the lethargy in the financial markets is a reflection not of uncertainty, but rather, exhaustion. After all, in the months immediately following the October stock price roll-back, the widespread expectation was that another shoe would soon drop, this time in the form of a global economic slump, or perhaps even worse. It wasn't until mid-spring before it became obvious–that such a business downturn would not materialize, and that the economy was still expanding.

However, no sooner had the fear of global recession subsided, than it was supplanted by concerns that the pace of business here and abroad was "too strong," and that a decided acceleration in the rate of inflation was just around the corner. Indeed, with the onset of spring, out came the crop of inflation bears–the financial market equivalent of dandelions. The bond-bashers had a field day for a while, "one-upping" each other with dire predictions as to how high the inflation rate would surge, how tight monetary policy would become and at what heights long-term interest rates would peak. Even the Federal Reserve was moved, repeatedly tightening monetary policy this spring.

The Case For Optimism

Only now is this year's inflation scare abating, and with good reason. Although the markets have yet to fully accept the fact, the weight of available economic evidence is beginning to tip the scales in the direction of somewhat slower economic growth in the months ahead, and the continued containment of inflation pressures. Retail sales remain as lackluster as they were several months ago, the housing picture is weak, industrial output growth is slowing and personal income gains are anemic. What is more, the results of the most recent September survey of the nation's purchasing agents again suggest that the economy is losing some of its forward momentum, notwithstanding continued employment gains and export order strength.

Any slowing of growth will lend support to bond and equity market psychology since it would reaffirm the growing view that the inflation reality is not only less threatening than earlier believed, but is actually fading. Consumer prices continue to rise at a modest clip, late summer rains have alleviated drought conditions in the Midwest, wages remain in check and industrial commodity

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prices have topped out. To reinforce matters, energy prices are again headed south.

With inventories high, and OPEC unable, or unwilling, to trim production, oil prices have softened steadily in recent weeks and could actually be headed for another tumble. As shown in the chart on page 1, spot prices of West Texas Intermediate crude, the U.S. benchmark, have already dropped by more than $5 per barrel since the spring to their lowest level in over two years. As recent price declines work their way through to the retail level, consumer prices in general will be held in check.

Will The Other Shoe Drop?

While one can build the case for optimism—moderate growth and modest inflation—words alone cannot banish the uncertainties surrounding the business or interest rate outlook or, for that matter, break the existing logjam in the financial markets. For that to happen, the Federal Reserve would have to switch its policy stance. With economic growth moderating, the inflation outlook brightening, money supply growth well-behaved and credit demand soft, a slight shift toward ease at some point may not be all that far-fetched.

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits of $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/21/88)	193,268	+ 872	+ 18,095
New York City (9/28/88)	38,889	— 12	+ 1,998
Commercial Paper (9/28/88)	420,797	— 70	+ 60,624

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/21/88)	297,049	+ 506	+12,687
New York City (9/28/88)	56,640	— 116	— 2,730

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/21/88)	896,496	+ 2,065	+42,755
New York City (9/.5/88)	171,972	— 1,958	— 7,520

Financial Markets

	Friday 10/7/88	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.48%	—0—	+ .52
180-Day Bills†	7.82	— .02	+ .14
Longest Bills†	7.99	— .13	— .22
Recent Issues:			
81/2S 9/30/90	8.22	— .18	
83/4S 9/30/92	8.37	— .19	
91/4S 8/10/98	8.68	— .16	
91/8S 5/15/18	8.80	— .17	
Municipals:			
Bond Buyer—20 Bond Index* (10/6/88)	7.53%	— .11	— 1.13
Blue List Total ($ Million)	$1,298	— $ 64	—$ 122
30-Day Visible Supply ($ Million)	$1,974	+ $313	—$ 233
Total	$3,272	+ $249	—$ 355
Corporates:			
Moody's Aa Composite (10/6/88)	9.77%	+ .09	— .96
30 Day Visible Supply ($ Million)	$5,028	+ $290	+$2,118
Stocks:			
*Dow-Jones Averages:			
Industrials	2,150.25	+ 37.34	—331.96
Transportation	929.21	+ 22.25	—107.67
Utilities	187.47	+ 5.93	— 8.59
65 Stocks	812.82	+ 17.37	—105.83
N.Y.S.E. Composite Index	156.81	+ 3.24	— 17.83
N.Y.S.E. Avg. Daily Vol. for Week (000's)	170,522	+ 41,580	— 5,523

*34% Taxable equivalent 11.41%. † Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 10/7/88	Week Ago
Overnight	8.13%	8.13%
1 month	8.18	8.25
3 month	8.44	8.56
6 month	8.50	8.63
1 year	8.63	8.75

FOREIGN EXCHANGE SPOT RATES New York Opening (10/7/88)	Currency Per U.S. $	Week Ago
Belgium	39.99	39.38
Canada	1.2100	1.2159
France	6.3385	6.4020
Germany	1.8595	1.8796
Italy	1387.00	1400.00
Japan	133.20	134.58
Mexico	2273.00	2273.00
Netherlands	2.1025	2.1195
South Korea	717.20	718.95
Switzerland	1.5810	1.5840
Taiwan	28.93	28.93
U.K.*	1.7015	1.6860

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (10/7/88) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/8
	—0.5%	—2.7%

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Nevertheless, that point has not yet been reached. It is certainly unlikely that Fed policy will be altered in any direction until after the elections, and until such time as more September economic statistics are available, either confirming the August business slowdown or, as some believe, pointing in the direction of a reacceleration of economic activity. According to this view, when the transitory effects on the economy of drought and hot weather are stripped away, signs of a business slowdown are few and far between.

Within the not-too-distant future, one of these views will be validated. Since the consensus of the day currently favors the stronger growth, more restraint scenario, it is hardly surprising that the equity market is treading water and long-term bond prices remain vulnerable. With little recent movement in either of these markets, the foreign exchange market too, has quieted.

However, while the financial markets continue to wait for the other shoe to drop, surprises do happen. One or two soft September economic numbers could produce a pleasant surprise for the markets—in contrast to that which occurred just about a year ago. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 10/5/88	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Govts and Agencies Owned Outright & RPs	236,658	— 1,040	+17,126
Loans to Depository Inst.	2,621	+ ,364	+ 1,428
Float	1,353	+ ,414	+ ,476
Total Reserve Bank Credit	258,706	— ,603	+20,798
Treasury Deposits with Federal Reserve Banks	9,890	— 2,319	+ 4,549
Currency in Circulation	235,859	+ ,763	+18,427
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	225,395	+ 1,318	+37,958
	10/5/88		
Member Bank Reserves:			
Total Reserves Held	60,134	— 1,052	+ 2,904
Excess (Deficiency)	1,310	+ ,531	+ ,477
Net Free Reserves	,575	+ ,692	+ ,468
		‡ % Change Since	
Monetary Aggregates †		**3 Months Ago***	**Year Ago**
M1 (9/26/88)	784.9	+ 4.1	+ 4.9
M2 (9/26/88)	3,032.5	+ 2.7	+ 5.4
M3 (9/26/88)	3,851.3	+ 5.8	+ 6.4
Domestic Nonfinancial Debt (2nd Q'88)	8,654.0	+ 8.1	+ 8.8

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 10/7/88	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	7.26%	7.41%	7.45%
* Federal Agencies	8.12	8.24	8.40
* Municipal Notes—High Grade (34% Taxable Equivalent)	8.33	8.71	8.79
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	8.28	8.40	8.49

‡ Finance Company Paper—Prime

5- 14 days	8.00%
15- 29 days	8.00
30- 59 days	8.00
60- 89 days	8.05
90-179 days	8.13
180-239 days	8.00
240-270 days	8.00

‡* Bankers' Acceptances

Nov.	8.01%
Dec.	8.03
Jan.	8.10
Feb.	8.10
Mar.	8.10
Apr.	8.10

‡ Industrial Paper—Prime

30- 89 days	8.11%
90-120 days	8.20

† Federal Funds Effective Rate 8.25%

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'88	$ 4,824	$ 4,725	$ 4,484
Gross National Product (1982 Dollars)*	2nd Q'88	$ 3,985	$ 3,956	$ 3,823
Percent Change, Annual Rate	2nd Q'88	3.0	3.4	5.0
Change in Consumer Prices*	Aug '88	4.8%	4.8%	4.8%
Change in MH Cost of Living Index	Aug '88	2.4%	7.2%	3.6%
Change in Producer Prices*	Aug '88	7.2%	6.0%	3.6%
Civilian Employment (Thousands of Persons) †	Sep '88n	115,328	115,180	112,872
Unemployment as % of Civilian Labor Force †	Sep '88n	5.4%	5.6%	5.9%
Personal Income*	Aug '88	$ 4,079	$ 4,071	$ 3,804
Leading Indicators Composite Index (1967=100) †	Aug '88n	193.4	192.7r	191.7
Industrial Production Index (1977=100) †	Aug '88	138.2	137.9	131.2
Net Change in Consumer Instaliment Credit †	Aug '88n	$ 5.44	$ 3.62r	$ 4.68
U.S. Merchandise Trade Balance †	Jul '88	—$ 9.53	—$ 13.22	—$ 13.88
Plant and Equipment Expenditures*	4th Q'88	$444.40(a)	$440.42(a)	$406.82
Private Housing Starts (Thousands of Units)*	Aug '88	1,436	1,485	1,583
New Construction Expenditures*	Aug '88n	$ 396.1	$ 398.3r	$ 398.3
Total Business Inventories †	Jul '88	$ 733.7	$ 731.5	$ 681.1
Total Business Sales †	Jul '88	$ 487.7	$ 488.8	$ 453.5

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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Francisco Goya, 1746-1828. General Palafox on Horseback, 1814. Museo del Prado, Madrid

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Goya and the Spirit of Enlightenment.
Metropolitan Museum of Art
April 23 - July 6, 1989.

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